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Management buyouts – the core ingredients for success

JOHN WALSH, REGIONAL SALES DIRECTOR FOR LEEDS AND NORTH-EAST, AT LEUMI ABL |
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Private equity has become increasingly active in its pursuit of UK companies in recent years, with 95 such buyouts recorded across the market in the first half of 2024 alone.

Once the takeover dust settles, attention on both sides of the boardroom inevitably shifts to determining exit strategies.

Alongside a private sale or public listing, another compelling option is a management buyout (MBO), where the existing management team acquires all or part of a company's shares or assets.

As with any change in ownership, there are no guarantees that even a successful and growing company will continue to perform strongly after an MBO. However, there are certain considerations that, if addressed, can put an MBO on the right track to ensure that the transition is as smooth as possible.

At a fundamental level, the success of an MBO hinges on finding an appropriate financing solution, and the right financial partner to support the management team. Without this, the transaction simply won't get off the ground.

It is also important to recognise that financing here is not just about having enough funds to cover the purchase cost, it is also essential that the business has sufficient liquidity to support its short, medium, and long-term strategy.

That means having ample funding to cover the legal and transaction costs of the MBO, the capital and operational expenditure required to run the business, and any funds needed to service existing debt.

On top of that, MBOs are rarely financed with one source of capital, so getting the deal structure right is crucial. Typically, it's a mix of senior and mezzanine debt, as well as institutional equity from the venture capitalists or private firms sponsoring the transaction.

This clearly increases the number of parties seeking to gain a return from the transaction, and makes finding the right financial partners essential.

In terms of the MBO itself, there are four key factors to take into account.

First of all, there are the existing owners or shareholders — while a key priority for them will be price point and whatever targets they have in place for an exit, the jurisdiction under which they operate is also an important factor, as the assignment of receivables varies by country, and completing a multi-jurisdictional transaction can be complex.

It's then important to turn to the intentions and ambitions of the management team. Along with the size of the stake they wish to acquire, there is also the question of their long-term strategy for growing the business, how much funding they need to execute their intended plans and at what rates.

It is also imperative that the management team have the resources in place to pursue a transaction while simultaneously ensuring the day-to-day operations of the business continue to run smoothly.

We then come to the lenders. The lending options available to a management team vary dramatically depending on sector, deal structure, and the size of a given transaction.

A lender will have its own hurdle rates and risk appetite, as well as a clear view on the desired length of any loan. Any lender will want to fully understand the context behind the transaction, the reasons why the existing owner is seeking an exit, and the likely growth profile of the business.

It will be looking for clarity about the management team's strategy; do they have a comprehensive and well thought through business plan and is this realistic in light of the funding they are seeking to acquire. Similarly, does the management team have a strong and established track record of delivery.

Finally, there is the question of process, the right financial partner is involved in the MBO process from the outset, to ensure it has a full understanding of the considerations and requirements of all the parties involved.

We (Leumi) like MBOs and anticipate an uptick in these transactions over the coming years, as they provide a clean path for an existing owner to successfully exit an investment, while safeguarding the long-term future of a business in the hands of a proven management team.

However, it is not a simple process and it is vital that all parties enter with their eyes wide open and with a willingness to show flexibility and work collaboratively to get the deal over the line. In this context, working with an established and experienced lender can make all the difference between success and failure.